11/18/80 B 4750-1

# Financial Markets

Irving Trust

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Friday (Noon) Nov. 14, 1980

The Federal Reserve faces several problems in the immediate and near future that will increase uncertainty concerning the course of monetary policy and will represent a real trial for policymakers.

The most immediate problem concerns the impact on required reserves of the Monetary Control Act's extension of reserve requirements to nonmember depository institutions and the reduction of the reserve requirements of member banks. The Fed earlier estimated the likely impact--probably a net $3-4 billion reduction of required reserves--so the volume of the reserve draining operation occasioned by the reserve requirements change is known. The difficulty is that the seasonal patterns by which the Fed estimates reserve "operating factors" may be altered by the new system. In particular the volume of excess reserves is likely to swell as the vault cash holdings of smaller nonmember institutions are included in total reserves, thus complicating the calculation of the impact of reserve availability on the level of the Federal funds rate. (The reason is that to the extent that excess reserves are held as vault cash, they will be unavailable for lending in the funds market, and thus cannot put downward pressure on the funds rate.) Needless to say, these problems will complicate life not only for the Fed's Open Market Desk but will impair, for a time, the ability of market participants to divine Fed policy shifts by sifting through reserves data.

Another problem for the Fed--and everybody else!--concerns the impact on the monetary aggregates of changing institutional structures. The M-1B money definition is destined to supersede the more obsolete M-1A which includes all NOW and similar interest-bearing deposits and none of the checkable shares of money market mutual funds. Our view is that some portion of both of these account types should have been included in M-1B. Money fund growth is likely to revive soon, even if rates move down toward the end of this year (for accounting reasons, money fund rates are especially attractive under such circumstances), and that will make M-1B understate money growth. Operating in the opposite direction is the fact that nationwide authorization of NOW accounts, which goes into effect at the start of 1981, will result in some transfer into M-1B of what are really savings accounts. How large the distortion will be no one--not even the Board Staff--currently can say with any confidence. The rub is that the M-1B money growth target will be adjusted to allow for the staff's best estimate of the distortion, and the adjustment easily might be in substantial error. Thus, were the adjustment too small, M-1B would tend to track above target, and vice versa if the adjustment were too big. Thus, it all adds up to an unusually uncertain and difficult environment in which to try to interpret--much less target--monetary growth.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

# Irving Trust

# Market Yields

| | 11/14/80 | Week Ago | Year Ago |
|---|---|---|---|
| **Prime Lending Rate at Irving Trust Company** | (Noon) | | |
| Short-term loans to substantial depositors with highest credit rating | 15.50% | 15.50% | 15.75% |
| Effective since | 11/6/80 | | |
| **Discount Rate at Federal Reserve Bank** | 11.00 | 11.00 | 12.00 |
| **Federal Funds** | 14.00 | 15.25 | 13.38 |
| **Repurchase Agreements** | 13.50 | 14.00 | 12.50 |
| **U.S. Treasury Issues** | | | |
| **Bills** | | | |
| 3 months | 13.85 | 13.88 | 12.30 |
| 6 months | 14.20 | 14.05 | 12.90 |
| 1 year | 13.75 | 13.80 | 12.35 |
| **Coupons** | | | |
| 2 years | 13.10 | 13.33 | 11.80 |
| 4 years | 12.90 | 13.25 | 11.12 |
| 7 years | 12.75 | 13.00 | 10.90 |
| 10 years | 12.65 | 12.97 | 10.75 |
| **Long Bond** | 12.30 | 12.45 | 10.40 |
| **Negotiable Certificates of Deposit-Secondary Market** | | | |
| 1 month | 15.00 | 14.90 | 13.90 |
| 3 months | 15.10 | 14.35 | 14.10 |
| 6 months | 15.00 | 14.10 | 14.15 |
| 1 year | 14.00 | 14.25 | 13.60 |
| **Banker's Acceptances** | | | |
| 1 month | 14.80 | 14.90 | 13.90 |
| 3 months | 15.20 | 14.85 | 14.20 |
| 6 months | 15.00 | 14.30 | 14.25 |
| **Eurodollar Deposits** | | | |
| 1 month | 15.19 | 15.88 | 14.50 |
| 2 months | 15.56 | 16.38 | 15.38 |
| 3 months | 15.63 | 16.50 | 15.38 |
| **Commercial Paper - Prime Names** | | | |
| **Directly placed by:** | | | |
| **Finance Companies** | | | |
| 1 week | 13.00 | 14.00 | 10.00 |
| 1 month | 13.75 | 14.63 | 13.50 |
| 3 months | 13.25 | 13.63 | 12.75 |
| **Bank Holding Companies** | | | |
| 1 month | 14.13 | 14.63 | 13.30 |
| **Dealer Placed:** | | | |
| 3 months | 14.38 | 14.50 | 13.63 |
| **New AA Corporate Utility Bond** | 14.50 | 14.63 | 11.75 |
| **Tax Exempt** | | | |
| 6 month Project Notes | 7.60 | 6.50 | 6.40 |
| 1 year AAA Bond | 7.00 | 7.40 | NA |
| 5 year AAA Bond | 7.00 | 7.20 | NA |
| 20 year AAA Bond | 8.75 | 9.00 | 6.80 |

This information represents prevailing market yields.
**It should not be construed as an offering.**
All yields are on the offered side of the market.

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